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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 630

BURFORD-TOOTHAKER TRACTOR COMPANY,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 35-48) are not officially reported. The opinion of the Court of Appeals (R. 90-93) is reported at 192 F. 2d 633.

JURISDICTION

The judgment of the Court of Appeals affirming the decision of the Tax Court was entered on No-

vember 16, 1951. (R. 93.) A petition for rehearing was filed on November 29, 1951 (R. 94), and was denied on December 7, 1951 (R. 99). The petition for a writ of certiorari was filed on March 6, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether the Tax Court's findings, under Section 23(a)(1)(A) of the Internal Revenue Code, of reasonable compensation allowances for taxpayer's two officers for the years 1941, 1942 and 1943, were clearly erroneous.

2. Whether the decision of the Board of Tax Appeals in *Burford-Toothaker Tractor Co.* v. *Commissioner,* involving the years 1935-1937, is a bar and estoppel to the assertion by the Commissioner of the unreasonableness of the compensation paid taxpayer's two officers for 1941-1943.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 23 [As amended by Sec. 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, or property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 111,[1] promulgated under the Internal Revenue Code:

Sec. 29.23(a)-6. *Compensation for Personal Services.*—Among the ordinary and necessary

[1] Treasury Regulations 111 are applicable to taxable years beginning after December 31, 1941. Section 19.23(a)-6 of Treasury Regulations 103 is here applicable to the period prior to December 31, 1941, and uses the same language as Section 29.23(a)-6 of Treasury Regulations 111.

expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

* * * *

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

* * * *

STATEMENT

So far as material here, the facts as found by the Tax Court may be summarized as follows:

The taxpayer is an Alabama corporation which was organized in 1934 for the purpose of engaging in the business of selling and servicing road working and dirt moving machinery, diesel engines, and

related equipment. Of its 1,500 shares of stock, 749 were held by its president, Harry H. Toothaker, one share by his wife, 749 shares by J. Lamar Burford, and one share by his wife. (R. 36.) Throughout taxpayer's existence, Toothaker and Burford have been its only officers. (R. 37).

The taxpayer's capitalization of 1,500 shares of common stock at $50,000 when organized had been increased to $150,000 by the end of 1940. Taxpayer's earned surplus account showed the following amounts: December 31, 1940, $49,123.87; December 31, 1941, $110,675.15; December 31, 1942, $404,616.12; December 31, 1943, $350,314.67. (R. 38.)

The following schedule shows the pertinent facts concerning the sales and financial operation of the business from 1935 through 1943 (R. 39):

Year	Total Sales	Compensation of 2 Officers (Total)	Dividends Paid
1935	$ 430,773.87	$23,538.80	.....
1936	669,988.77	32,800.00	$10,000
1937	874,660.00	40,986.40	10,200
1938	730,116.36	35,204.64	6,780
1939	1,013,260.77	46,530.44	10,560
1940	1,211,558.59	54,462.84	12,000
1941	1,846,111.05	79,844.44	12,000
1942	2,280,348.95	97,213.22	12,000
1943	1,562,840.47	68,492.04	12,000

The taxpayer's business was managed and supervised solely by its two officers, Burford and Toothaker. They worked together as a team. They

devoted all of their time to the business working six days a week, an average of two or three nights a week, and often on Sunday. They participated in various ways in most sales. Taxpayer had other salesmen in its organization, the same number in the taxable years as in 1935 and 1936.[2] Taxpayer's two officers were away from their offices a substantial amount of time for various reasons. They were away for the purpose of working on sales, collecting accounts, or making trips to Washington to prevail on the War Production Board to grant priorities on equipment to taxpayer's customers. (R. 40.) They also paid visits to the factory of the Caterpillar Tractor Company from which taxpayer had an exclusive territorial sales franchise. These visits were "not required" but were made because taxpayer wanted "to keep in contact with those fellows". (R. 40, 56, 59.)

During the years in question, taxpayer's officers had additional work arising out of their attempts to secure draft deferments for certain vital employees, and to comply with war regulations. The demand for machines sold by the taxpayer in-

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[2] In an earlier case involving the same company and the same two officers for the taxable years 1935, 1936, and 1937, the compensation paid was held to be reasonable. See *Burford-Toothaker Tractor Co.* v. *Commissioner,* decided October 20, 1941 (1941 P-H B.T.A. Memorandum Decisions, par. 41,463). The findings of fact and opinion in that proceeding were incorporated by reference by the Tax Court in this case. (R. 40.)

creased in each of the taxable years, over the previous year, but the supply decreased. In 1941, equipment was in free supply. Taxpayer could get all the equipment it could sell and had to sell all it got. Later, customers were begging for machines. People regularly came into taxpayer's office to call on the officers, when ready to buy equipment. The officers also made sales over the territory covered by taxpayer. During the first part of the period here involved, taxpayer's officers encountered some sales resistance, but, after 1941, there was no sales problem of consequence. (R. 40-41, 46.) The big problem after 1941 was the acquisition of machinery (new and used) to sell. One method used to alleviate this problem was to obtain new lines from other manufacturers to help fill out the scarcity of new equipment needed. (R. 41.)

During the taxable years, it was difficult to obtain employees with experience to work for taxpayer. During this period, taxpayer lost one department head who has not as yet been replaced. The following schedule indicates the amount of change in the number of employees in taxpayer's organization during the taxable years (R. 41):

Year	Number of employees at beginning of year	New employees hired	Number of employees at end of year	Gain or (Loss)
1941	42	28	53	11
1942	53	45	52	(1)
1943	52	45	59	7

Taxpayer's two officers interviewed all new employees and supervised their training. (R. 41.)

The operation of the taxpayer required borrowing from banks which was at one time during the taxable years as high as $425,000. All of these borrowings were individually guaranteed by the indorsement of Burford and Toothaker, who together had a net worth of approximately $500,000. (R. 41.)

Except for a slight deviation in the year 1935, the annual salaries of Burford and Toothaker, since the formation of the corporation through the year 1943, have been, for each, $9,000 plus 2 per cent on all sales in excess of $300,000. The additional compensation, above the $9,000 for each of the two officers, was provided for 1941 by resolution of the Directorship on December 19, 1941, and was applied to 1942 and 1943 by resolutions passed December 17, 1942, and December 16, 1943, respectively. (R. 42.)

The Commissioner disallowed, for each of the taxable years, and for each of the officers, all of the amount paid for salaries in excess of $25,000. (R. 42.)

On the basis of the foregoing, the Tax Court held that the amounts paid by the taxpayer for Burford and Toothaker constituted reasonable compensation for personal services actually rendered, to the extent, respectively, for each of the two officers, as follows: 1941—$37,500; 1942—$40,000; and 1943—$30,000. (R. 42.)

The Court of Appeals affirmed the Tax Court's decision. (R. 90-93.)

ARGUMENT

1. As petitioner concedes, the question as to the reasonableness of the compensation which the taxpayer paid to its officers is one of fact, and the sole question before the Court of Appeals on this phase of the case was whether the Tax Court's finding as to the amounts which constituted reasonable compensation to each of the taxpayer's officers in each of the taxable years here in question was clearly erroneous. The Court of Appeals held that such finding was not. It is well settled that this Court will accept the concurrent findings of the two courts below on matters of fact. *Texas & N. O. R. Co.* v. *Ry. Clerks,* 281 U. S. 548, 558; *Allen* v. *Trust Company of Georgia,* 326 U. S. 630, 636. As this Court said in *Comstock* v. *Group of Investors,* 335 U. S. 211, 214, this is a seasoned and wise rule and is not to be departed from "in the absence of very exceptional showing of error."

Such showing has not been made here. On the contrary, the careful opinion of the Tax Court, canvassing such factors as the extent to which sales should be attributed to the efforts of the two officers involved, the absence of any sales problem of consequence, and the facts suggesting that taxpayer was, in reality, attempting to distribute its earnings through salary payments to its officer-stockholders instead of by dividends (R. 45-48),

makes evident that the conclusion it reached was a reasonable one. As the Tax Court pointed out (R. 48), the formula on which compensation was paid to its officers by taxpayer, being based on a percentage of sales, could not control because "after 1941, conditions as to sales were such that the officers' efforts alone did not reflect the sales."

Moreover, the court below was plainly correct in holding that that portion of the testimony of the taxpayer's witnesses which stated their conclusions as to the reasonableness of the compensation which the taxpayer paid to its officers, did not bind the Tax Court. *Dayton P. & L. Co.* v. *Comm'n,* 292 U. S. 290, 299; *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, 295. For here, as the Tax Court's opinion makes clear (R. 45-48) and as the court below noted (R. 92), there was evidence which contradicted the taxpayer's witnesses' conclusions and supported the findings of the Tax Court. Consequently, there is no merit in the taxpayer's contention (Br. 8-11) that the decision of the court below is in conflict with certain decisions of the Sixth Circuit Court of Appeals in cases in which that court found there was no contradiction of the witnesses' testimony as to the reasonableness of the amounts of compensation claimed to be deductible.

2. In the very nature of things, the finding of the Board of Tax Appeals on the evidence before it in a prior proceeding, that certain amounts consti-

tuted reasonable compensation to the taxpayer's officers in prior years, did not estop the Commissioner or the Tax Court from finding that other amounts constituted reasonable compensation to them in the taxable years here in question. The facts in the two proceedings are different. For example, there was a shift from the buyer's market which had prevailed since the depression through 1935, 1936 and 1937, the taxable years involved in the prior proceeding, to a seller's market which prevailed in varying intensity during 1941, 1942 and 1943, here in question. Moreover, sales in the prior years consisted largely of new machinery and equipment, whereas in the years here in question sales included new and increasingly large quantities of used machinery and equipment. Also, the amount of rebuilding work substantially increased in the later years. (R. 62.) Thus, as the Tax Court stated in its opinion, the question was different, involving facts of a different period, and different conditions. (R. 43-44.) In these circumstances, the earlier decision of the Board of Tax Appeals could not estop the Commissioner in this case. *A fortiorari*, the Bureau acquiescence in compensation deductions for earlier years could not. See *Commissioner* v. *Sunnen*, 333 U. S. 591, 599-600.

CONCLUSION

The decision of both courts below is correct and there is no conflict. Hence, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL, 1952.

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